No. 82-1672

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In The

Supreme Court of the United States

October Term, 1982

USM CORPORATION,

Petitioner,

vs.

SPS TECHNOLOGIES, INC.,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF OF RESPONDENT IN OPPOSITION

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COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

1. Whether the Court of Appeals properly reversed the District Court, which failed to adhere to the universally accepted application of the doctrine of *res judicata.*

2. Whether the Court of Appeals properly affirmed the District Court, which found there was no fraud on the court or on petitioner USM in a prior action.

LISTING PURSUANT TO RULE 28.1

SPS Technologies, Inc. ("SPS") does not have a parent corporation. SPS has the following affiliates: Fastener, Inc. (a Connecticut corporation) and foreign affiliates, Metalac S.A. Industria e Comercio (Brazil) and Precision Fasteners Ltd. (India).

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October Term, 1982

USM CORPORATION,

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vs.

SPS TECHNOLOGIES, INC.,

Respondent.

BRIEF OF RESPONDENT IN OPPOSITION

OPINIONS BELOW

Petitioner USM inexplicably neglected to include in the appendix the earlier opinion of the District Court, reported at 453 F.Supp. 753 (N.D. Ill. 1978), although this decision was also reviewed by the Court of Appeals, 694 F.2d 505, 506 (7th Cir. 1982) (A77). This earlier decision, by the same District Court judge who rendered the decision reported at 514 F.Supp. 213 (N.D. Ill. 1981) (A1), is relevant and germane to the issue of the application of the doctrine of *res judicata* in patent litigation.

Accordingly, SPS has reproduced that opinion in a supplemental appendix bound with this brief.[1]

JURISIDICTION

The judgment of the Court of Appeals for the Seventh Circuit was entered on December 3, 1982. A timely petition for rehearing *en banc* was denied on January 11, 1983, and the petition for certiorari was filed within 90 days of that date. USM invokes this Court's jurisdiction under 28 U.S.C. §1254(1).

STATEMENT OF THE CASE

A. The Nature of the Case and the Disposition in the Court Below

This case presents an ordinary patent controversy between two large industrial corporations. At the center of the controversy is SPS' Villo patent.[2] In 1969 SPS sued USM for infringement of the Villo patent, *Standard Pressed Steel Co. v. Coral Corporation and USM Corporation*, 69 C 2538 (N.D. Ill.).[3] USM interposed defenses that the Villo patent was invalid, not infringed and that USM had grant-back license rights because of an earlier licensing arrangement. The grant-back license issue was tried first and USM's challenges to the infringement and validity of the Villo patent were severed for a later trial. SPS prevailed on the grant-

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1. Reference herein to the appendix bound with USM's petition will be designated "A" followed by the page number and to the supplemental appendix as "SA" followed by the page number.

2. U.S. Patent No. 3,093,177 issued June 11, 1963 and which expired in June of 1980.

3. SPS Technologies, Inc. was formerly known as Standard Pressed Steel Co.

back license issue, *Standard Pressed Steel Co. v. Coral Corp.*, 168 USPQ 741, *modified,* 170 USPQ 83 (N.D. Ill. 1971). USM then abandoned its challenge to the validity and its infringement of the Villo patent, and in May 1971 agreed to the entry of a judgment order on consent. That 1971 consent judgment held that the Villo patent was valid and had been infringed by USM. USM also entered into a license agreement with SPS by taking a license under the Villo patent.

Peace between USM and SPS with respect to the Villo patent was relatively short-lived. In June 1974 USM filed a declaratory judgment action against SPS. This action again raised USM's challenge to the validity and its infringement of the Villo patent. Thus, since 1969 the Villo patent has been involved in litigation between USM and SPS for some eleven years.

In this 1974 action USM sought, *inter alia,* vacation of certain provisions of the 1971 consent judgment (Count I); a declaration of invalidity and USM's noninfringement of the Villo patent (Count III); and a declaration that the Villo patent was void and unenforceable because of (a) SPS' alleged fraud on the Patent Office in its procurement of the Villo patent and (b) SPS' alleged inequitable conduct and unclean hands in the conduct of the prior action which USM asserted was fraud on it and on the court (Count IV).

In the 1978 opinion, which USM failed to include in its appendix, the District Court held that the prior 1971 consent decree acknowledging the Villo patent valid and infringed by USM barred USM from relitigating those same issues under the doctrine of *res judicata* (SA7-11). The District Court granted summary judgment dismissing USM's Count III which sought a declaration of the Villo patent's invalidity and USM's noninfringement of it. The court further held that only the allegations of Count IV (the fraud count) remained for trial (SA13).

After a trial on USM's Count IV fraud issue, the District Court issued its order (A1) finding the Villo patent invalid. However, it also found that SPS had not committed a fraud on the court or on USM in the prior action which resulted in the 1971 consent decree. Both parties appealed this decision. The Court of Appeals vacated the District Court finding that the Villo patent was invalid and affirmed the orders finding SPS had not committed fraud on USM or the court in the prior action and the finding (SA1) according a *res judicata* effect to the prior consent decree.

B. The Real Issues USM Attempts to Raise in its Petition

The crux of the complaint raised by USM's petition is an attack on the Court of Appeals' holding that the prior consent decree adjudicating the validity and USM's infringement of the Villo patent should be accorded full *res judicata* effect. Stripped to its essentials USM wants this Court to carve out an exception to the application of the doctrine of *res judicata.* The Court of Appeals below refused to follow USM's urging to make such an exception to the application of the doctrine of *res judicata* (A80); and it followed its prior holding in *American Equipment Corp. v. Wikomi Mfg. Co.*, 630 F.2d 544 (7th Cir. 1980). The *Wikomi* decision had finally harmonized the Seventh Circuit's treatment of consent decrees in patent cases, where both validity and infringement had been adjudicated, with all of the other federal circuits which had considered the same issue. *See Vulcan, Inc. v. Fordees Corp.*, 658 F.2d 1106 (6th Cir. 1981), *cert denied,* 456 U.S. 906 (1982); *Interdynamics, Inc. v. Firma Wolf,* 653 F.2d 93 (3rd Cir.), *cert. denied,* 454 U.S. 1092 (1981); *Wallace Clark & Co., Inc. v. Acheson Industries, Inc.*, 532 F.2d 846 (2nd Cir.), *cert. denied,* 425 U.S. 976 (1976); *Schlegel Mfg. Co. v. USM Corp.*, 525 F.2d 775 (6th Cir. 1975), *cert. denied,* 425 U.S. 912 (1976); *Broadview Chem. Corp. v. Loctite Corp.*, 474 F.2d 1391 (2nd Cir. 1973); *Schnitger v. Canoga Electronics Corp.*, 462 F.2d 628 (9th Cir. 1972); *United States ex rel. Shell Oil Co. v. Barco*

Corp., 430 F.2d 998 (8th Cir. 1970);*Crane Boom Life Guard Co. v. Saf-T-Boom Corp.*, 362 F.2d 317 (8th Cir. 1966), *cert. denied*, 386 U.S. 908 (1967).[4]

This issue is embraced by SPS' counterstatement question 1 and is apparently the question presented by USM's petition in questions 1 and 2.

The second question presented in SPS' counterstatement embraces the third and fourth questions presented by USM's petition. USM seeks review by this Court of the findings by the District Court below, affirmed by the Seventh Circuit, that SPS committed no fraud on the court or on USM in the prior action.

USM's fifth proposed question is not proper for review by this Court as the issue raised there has not been reviewed by the Court of Appeals below. The court below found it unnecessary to reach this issue in view of the disposition it made and, thus, there is no final ruling subject to review by this Court.

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4. In any event, in patent cases such as this one there will no longer be conflicts between the circuits as the new Court of Appeals for the Federal Circuit now has jurisdiction to hear all patent appeals. The uniformity of decisions in patent cases from this new court will remove conflicts between the circuits in patent cases. Thus one criterion for exercising discretion for issuing a writ of certiorari, pursuant to Supreme Court Rule 17, will no longer be present.

REASONS FOR DENYING THE WRIT

I.

USM has failed to demonstrate any need for review by this Court.

Supreme Court Rule 17 provides guidelines to "indicate the character of reasons that will be considered" for exercise of this Court's discretion in issuing a writ of certiorari. The decision of the Court of Appeals below is not "in conflict with the decision of another court of appeals on the same matter," does not depart "from the accepted and usual course of judicial proceedings" and has not "sanctioned such a departure by a lower court, as to call for an exercise of this Court's power of supervision." Further, the Court of Appeals below did not decide "an important question of federal law which has not been, but should be, settled by this Court," or decide "a federal question in a way in conflict with applicable decisions of this Court."

II.

The Court of Appeals below applied the correct rationale in reaching its decision.

The fundamental thrust behind the decision of the Court of Appeals below was an awareness to preserve and protect the judicial process through a recognition that there must be a finality to litigation. The doctrine of *res judicata,* as enuciated since *Cromwell v. County of Sac,* 94 U.S. 351 (1877), has the avowed purpose of putting an end to litigation between the same parties regarding the same issues. Consent decrees have long been held to have the same *res judicata* effect as decrees entered after a trial on the merits. *Burgess v. Seligman,* 107 U.S. 20 (1882); *Harding v. Harding,* 198 U.S. 317 (1905); *United States v. Swift*

& Co., 286 U.S. 106 (1932); *United States v. Southern Ute Tribe or Band of Indians*, 402 U.S. 159 (1971).

The application of the doctrine of *res judicata* significantly affects judicial administration by reducing the workload of overburdened courts, discouraging piecemeal and repetitive litigation, promoting certainty in legal relations and generally fostering respect for the judicial process. While the application of the doctrine in some circumstances may, at first blush, seem harsh and unjust, relaxation of this basic and proven judicial principle by allowing *ad hoc* exceptions will, in the long run, create greater havoc and uncertainty than good. The Court of Appeals below recognized the danger inherent in allowing exceptions to chip away at the certainty of the doctrine of *res judicata*. Other courts have also declined to create exceptions. This is especially so in the patent area. *See generally*, the *Wallace Clark, Wikomi,* and *Interdynamics* decision, *supra* and Note, *To Bind or Not to Bind: Bar and Merger Treatment of Consent Decrees in Patent Infringement Litigation*, 74 Colum. L.Rev. 1322 (1974).

USM is also not the innocent babe in the woods, duped by an unscrupulous and more powerful adversary into accepting a consent decree, which USM's petition tries to convey. It is, and was, a larger corporate entity with greater assets and sales than SPS. In findings not now subject to challenge, the District Court found that USM *knew* in the prior action of the earlier abandoned Villo patent application (FF. 104 A64), *knew* that SPS had been aware of the Parker patent and that SPS had not cited it to the Patent Office (FF. 105 A64), and *knew* of the statements in the Epstein application through a corresponding British patent (FF. 123 A70). These were the factors upon which the District Court made its fraud finding.[5]

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5. SPS on appeal vehemently argued that the District Court's finding of fraud was erroneous. SPS still asserts that had the Court of Appeals found (Cont'd)

In these findings it is clear that USM, had it pursued the first action instead of settling, had available to it in 1971 all the discovery and information necessary to have made the same fraud attack on the Villo patent before assenting to the consent decree.

USM, through the head of its involved operation, admitted in deposition testimony that USM settled the first action because it was economically unjustifiable to continue, especially in view of the license it obtained from SPS.[6] When the amount of royalties USM was paying to SPS under the license made it economically justifiable to bring the second action, USM felt that it was in the fortuitous circumstance of being able to keep the license and challenge the Villo patent at the same time. According to USM's executive this afforded USM a "riskless advantage."[7]

It is submitted that the finality of litigation through the application of the doctrine of *res judicata* should not be changed,

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(Cont'd)
it necessary to review the finding of fraud on the Patent Office, SPS would have prevailed. Further, for USM to state that the Court of Appeals accepted the fraud findings as "amply supported by the evidence" is a mischaracterization. The Court of Appeals said it had not considered that issue (A79). It did not have to do so.

6. Pertinent excerpts of the deposition of William F.G. Dawson, USM's executive, appear in the supplemental appendix to this brief at SA14.

7. USM is no stranger at attempting to relitigate a patent after accepting a consent decree, *Schlegel Mfg. Co. v. USM Corp.*, 525 F.2d 775 (6th Cir. 1975), *cert. denied*, 425 U.S. 912 (1976). In further commentary on standing firm on *res judicata* the Sixth Circuit in *Vulcan, Inc. v. Fordees Corp.*, 658 F.2d 1106, 1111 (1981), *cert. denied*, 456 U.S. 906 (1982) said "We see no reason in this case to exalt purely private, economic interest advanced by Fordees above either of the competing public interests present in Schlegel." Again, only USM's purely private interests are involved here. There is no public interest at all in the now expired Villo patent.

especially in patent cases which are known to be inordinately complex, time consuming and expensive. *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation,* 402 U.S. 313, 334-341 (1971). The underlying finality rationale of *Blonder-Tongue,* estopping the patentee who has once litigated his patent to a final determination of invalidity, is equally applicable to a defendant in a patent action who first begins to challenge a patent's validity and then accepts a consent decree of validity and an acknowledgment of infringement. This is especially true in this case where the District Court made extensive findings of what USM knew in the prior action, or could have obtained through discovery available to it, regarding the attack USM made in the present action against the Villo patent. The Court of Appeals below (A80) understood the implications of this when it stated:

> "But such an exception [to the doctrine of *res judicata*], rather than detering patent fraud, would reduce the incentive of an infringer to prove fraud when first sued; he would have nothing to lose by biding his time until the terms of the settlement became onerous to him."

This is exactly what USM has done in this instance, *see* Dawson deposition excerpt (SA14-17).

The Court of Appeals below recognized the necessity of preserving the doctrine of *res judicata* and all the benefits deriving therefrom. Its opinion was a clear instruction to the District Court that it was error to entertain an attack against a patent which had been adjudicated against the same party to be valid and infringed. Even though the District Court embarked on the wrong course and received evidence, which it theorized indicated the

patent had been fraudulently procured,[8] it should not have done so. According to the Court of Appeals below, it is sounder judicial policy to have a clear, uniform and consistent application of the doctrine of *res judicata.*

III.

USM's implication that the decision below is in conflict with applicable decisions of this Court is fallacious.

USM's implication that the decision below is contrary to applicable decisions by this Court is untenable, and its analysis of the law reaches a fallacious conclusion. USM's petition, at p. 9, stated that this Court in *Lear, Inc. v. Adkins,* 395 U.S. 653 (1969) overruled *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.,* 339 U.S. 827 (1950). USM's argument continues with the faulty premise that, since *Automatic Radio* involved a consent decree admitting patent validity and infringement, there is authority in this Court for the proposition that consent decrees in patent cases are *per se* unenforceable on public policy grounds.

Lear overruled *only* that aspect of the holding of *Automatic Radio* which held that a licensee was estopped to challenge the validity of the licensed patent. The consent decree was never an issue addressed by any court in *Automatic Radio.* In the lower court opinion, *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.,* 77 F. Supp. 493, 497 (D. Mass. 1948), the court, commenting upon only the contract issues before it, said:

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8. *See* note 5. The evidence adduced also failed to pinpoint any single person or single act which was termed fraudulent. Instead the District Court relied on a series of unrelated events spanning many years which the court theorized must have been known by SPS.

> "The short answer is that the consent decree is *not* a part of this contract. . . . The legal effect of the consent decree need *not* be passed upon in this suit." (Emphasis added.)

For USM to imply there is authority in this Court for the proposition that consent decrees in patent cases are *per se* unenforceable on public policy grounds is erroneous. This Court never had any issue of the patent consent decree before it in *Automatic Radio* and has never implied that consent decrees in patent cases are unenforceable on public policy grounds. The circuits are now uniform in according *res judicata* effect to consent decrees in patent cases where the decree acknowledged both the validity and infringement of the patent.

Also noteworthy is that the Court of Appeals below, rather than ignoring important public policy considerations and controlling Supreme Court precedents, followed what this Court has long held. In *Federated Dept. Stores, Inc. v. Moitie,* 452 U.S. 394 (1981), this Court rejected an unprecedented departure from accepted principles of *res judicata* on the basis that justice is best achieved when a complex body of law developed over a period of years is evenhandedly applied. The Court found that the doctrine of *res judicata* serves vital public interests beyond any individual judge's *ad hoc* determination of the equities in a particular case. This is exactly what the Court of Appeals below determined was the best course of action when it rejected the District Court's "Solomonic approach of giving the consent decree some but not complete res judicata effect" (A80).

This Court has long recognized that public policy dictates that there be an end to litigation and that those who have once contested an issue shall be bound by the result of the contest. *Baldwin v. Iowa State Traveling Men's Association,* 283 U.S. 522, 525 (1931). The doctrine of *res judicata* is not a matter of practice

or procedure, "[i]t is a rule of fundamental and substantial justice, 'of public policy and of private peace,' which should be cordially regarded and enforced by the Courts." *Hart Steel Co. v. Railroad Supply Co.*, 244 U.S. 294, 299 (1917).

As noted in *Federated Dept. Stores, Inc., supra,* the language used by the Court in *Reed v. Allen,* 286 U.S. 191 (1932) is even more compelling today in view of the crowded court dockets. In *Reed* this Court stated, at 198-199:

> "The predicament in which respondent finds himself is of his own making . . . we cannot be expected, for his sole relief, to upset the general and well-established doctrine of res judicata, conceived in the light of the maxim that the interest of the state requires that there be an end to litigation — a maxim which comports with common sense as well as public policy. And the mischief which would follow the establishment of precedent for so disregarding the salutary doctrine against prolonging strife would be greater than the benefit which would result from relieving some case of individual hardship."

There is no need to depart from these principles in this case.

IV.

The Court of Appeals properly affirmed the District Court's finding there was no fraud on the court in the prior action.

The position taken by USM's petition on this issue is somewhat of a non sequitur, which of necessity requires consideration of the facts found by the District Court to absolve SPS of the fraud on the court charge. These fact findings detail

the degree of USM's knowledge of, or the ability to obtain, the facts USM asserted showed a fraudulent procurement of the Villo patent. However, they also show that the individuals responsible for conducting that litigation on behalf of SPS had *no* knowledge of the relevant documents upon which USM asserted fraud attached.

SPS maintained below and, maintains here, that it was not guilty of any fraudulent acts with respect to the procurement of the Villo patent. How then can SPS be said to have committed a fraud on the court by presenting a consent decree if it did not then, and still does not, consider any of its acts to be tainted with any fraud? How can any unknowing act be an *a fortiori* fraud as USM would have this Court consider?

The common law elements of fraud require (1) a material misrepresentation (2) that is false and (3) known to be false by the maker, or made recklessly as a positive assertion without knowledge of its truth and (4) made with the intention that it be acted or relied upon coupled with (5) the reliance by another (6) to his damage or injury. 37 C.J.S. *Fraud* §3 at 215-18 (1943). Under the findings of fact entered by the District Court and affirmed by the Court of Appeals, it is clear that there was no evidence presented which would meet these essential criteria for finding fraud.

As found by the District Court, USM knew of the existence of much of the evidence it later used to raise the issue of fraudulent procurement and could have availed itself in the first action of other discovery had it so chose. Instead, USM chose to settle the prior action because of economic justifications and later resurrect its challenge of the Villo patent when it had the "riskless advantage."

CONCLUSION

The Court of Appeals correctly balanced the public policy considerations and correctly determined that for reasons of effective judicial administration, the finality of litigation and fostering respect for the judicial process it should not make any exceptions to the applicability of the doctrine of *res judicata* in patent cases where a prior consent decree acknowledged both the validity and the infringement of a patent. The writ should not be granted. "The jurisdiction to bring up cases by certiorari . . . was not conferred upon this Court merely to give the defeated party in the Circuit Court of Appeals another hearing." *Magnum Co. v. Coty*, 262 U.S. 159, 163 (1923). This is what USM seeks here.

Respectfully submitted,

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SUPPLEMENTAL APPENDIX

OPINION OF THE DISTRICT COURT OF JUNE 12, 1978 REPORTED AT 453 F. SUPP. 753

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS EASTERN DIVISION

NO. 74 C 1514

USM CORPORATION

Plaintiff,

vs.

STANDARD PRESSED STEEL CO.,

Defendant.

Before Honorable Nicholas J. Bua, Judge
United States District Court

This is an action brought by a patent licensee seeking, among other relief, a declaration of the invalidity, and its non-infringement, of the underlying patent. The parties have both been involved for many years in the manufacture of patch-type self-locking threaded fasteners.[1] Defendant Standard Pressed Steel

1. Such a fastener is, in simple terms, a bolt with a patch of nylon or nylon composition material affixed to the threaded surface. When the bolt is threaded into its counterpart member the compression of the nylon causes it to resist loosening which might otherwise result from vibration or movement.

(SPS) is the assignee of a 1963 patent No. 3,093,177 (issued to Joseph Villo) relating to the production of such fasteners. In December, 1969, SPS brought suit in this court against the plaintiff herein, USM Corporation (USM) and a licensee of USM, alleging infringement of that patent. Negotiations followed, resulting in an April, 1971, agreement by which USM was licensed under the Villo patent and, under certain conditions, was granted a non-exclusive license to sublicense. Provisions of the agreement reciting the validity of the Villo patent, the scope of its claims, and the fact of USM's infringement were incorporated into a consent decree, dated May 3, 1971, disposing of the litigation.

For about three years USM paid royalties under the license agreement. However, it refused to make a payment falling due in April, 1974. Shortly thereafter, SPS correctly informed USM by letter that under the terms of the license agreement, if the royalty payment was not made within a sixty day cure period SPS would be entitled to terminate the agreement. On June 4, 1974, USM brought this action, asserting on various grounds the invalidity and unenforceability of the Villo patent, and that it had not infringed. Count VII of the amended and supplemental complaint sought an injunction *pendente lite* relieving USM of its obligation to pay royalties. By agreement of the parties, the withheld royalty payment and the following one were paid to SPS under court orders which in effect permitted SPS to hold the funds pending the outcome of the litigation. SPS then refused to continue this procedure, and the court denied USM's request for an injunction *pendente lite*. This ruling was affirmed on appeal. *USM Corp. vs. Standard Pressed Steel Co.*, 524 F. 2d 1097 (7th Cir. 1975).

Opinion

Presently before the court are four motions by the defendant, SPS.

SPS has moved to dismiss Count III of the amended and supplemental complaint for lack of subject matter jurisdiction. Count III seeks a declaration that the Villo patent is invalid for failure to comply with 35 U.S.C. §§101, 102, 103, and 112, and that it has not been infringed by USM. SPS argues that unless the licensee first repudiates his license by withholding royalty payments, such a claim neither presents a justiciable controversy nor arises under the patent laws. The court is reminded in this connection that USM has of its own volition continued paying royalties in order to preserve its license. This argument, however, must fail.

First, where a licensee reasonably fears that if he withholds royalty payments an infringement suit will be forthcoming his request for a declaration of the invalidity of the underlying patent clearly presents a justiciable controversy. To establish an actual controversy in an action challenging the validity of a patent the plaintiff must (1) disclose conduct on the part of the defendant that makes reasonable the plaintiff's apprehension that he will face an infringement suit or the threat of one if he commences or continues a given activity, and (2) show that he has a real stake in the outcome of the controversy, i.e., a real interest in commencing or continuing the activity in question. *See Super Products Corp. v. DP Way Corp.*, 546 F. 2d 748, 753 (7th Cir. 1976); *Stickler Industrial Supply Corp. v. Blaw-Knox Co.*, 367 F. 2d 744 (7th Cir. 1966). Here, the license agreement provides that SPS may terminate the license upon the default of USM. Moreover, SPS has suggested its intention to do so should the opportunity arise. USM's stake in the outcome lies in its desire

to avoid liability for royalties. There is, then, an actual case or controversy. *See, e.g., Warner-Jenkinson Co. v. Allied Chemical Corp.*, 567 F. 2d 184, 187 n. 4 (2nd Cir. 1977); *Dahlgren Manufacturing Co. v. Harris Corp.*, 399 F. Supp. 1253, 1255-56 (N.D. Tex. 1975).

Secondly, in this case, the declaratory action arises under the patent laws. Where the declaratory plaintiff is already the defendant in a state court action on the license for royalties, and where diversity is lacking, the declaratory action does not arise under the patent laws because it is brought solely as a means of defending a state court suit. *Milprint, Inc. v. Curwood, Inc.*, 562 F. 2d 418 (7th Cir. 1977); *Thiokol Chemical Corp. v. Burlington Industries, Inc.*, 448 F. 2d 1328 (3d Cir. 1971) *cert. denied* 404 U.S. 1019; and *see Public Service Commission of Utah v. Wycoff Company, Inc.*, 344 U.S. 237, 248, 73 S. Ct. 236, 242, 97 L. Ed. 291 (1952). However, where, as here, there is a reason for anticipation of an infringement action, a different conclusion should result. As the court said in *Warner-Jenkinson Co. v. Allied Chemical Corp., supra,* 567 F. 2d at 187-88:

> "We first address the question of subject matter jurisdiction, ...The Declaratory Judgment Act, 28 U.S.C. § 2201, does not independently create federal jurisdiction. According to Skelly Oil Co. v. Phillips Petroleum Co., 339 U.S. 667, 671-72, 70 S.Ct. 876, 94 L.Ed. 1194 (1950), an action for declaratory judgment may be brought in federal court ordinarily only if there would exist a basis for federal jurisdiction in a coercive action between the two parties. See also Public Service Commission v. Wycoff Co.,

344 U.S. 237, 249, 73 S.Ct. 236, 97 L.Ed. 291 (1952). If the plaintiffs were seeking a declaration simply of their right to assert patent invalidity as a defense to a contract action for royalties, which itself could not be brought in federal court, see e.g., Luckett v. Delpark, 270 U.S. 496, 502, 510, 46 S.Ct. 397, 70 L.Ed. 703 (1926); Arvin Industries, Inc. v. Berns Air King Corp., 7 Cir., 510 F.2d 1070 (1975); see generally Louisville & Nashville R.R. v. Mottley, 211 U.S. 149, 29 S.Ct. 42, 53 L.Ed. 126 (1908), one might conclude that no 'arising-under' jurisdiction would be present. See Thiokol Chemical Corp. v. Burlington Indus., Inc., 448 F.2d 1328, 1330-31 (3d Cir. 1971), cert. denied, 404 U.S. 1019, 92 S.Ct. 684, 30 L.Ed. 2d 669 (1972). See also Hanes Corp. v. Millard, 174 U.S. App. D.C. 253, 531 F.2d 585, 594-95 n.8 (1976).

However, a second, and perhaps more important, reason why the plaintiffs want a declaration of patent invalidity is for its use as a defense in a patent infringement action. Under their licensing arrangement, nonpayment of royalties constitutes a material breach which gives the patentee the right to terminate the license prospectively. Thus, within a few months after the plaintiffs become liable for payment of royalties under contract law, they will also be subject to an action in federal court for an injunction and damages for infringement, see Luckett v. Delpark, supra, 270 U.S. at 510, 46 S.Ct. 397. At the present

> time the defendant has neither a state contract action nor a federal infringement action since the plaintiffs have not stopped paying royalties. One act on the part of the declaratory plaintiffs nonpayment of royalties, will leave them vulnerable to federal as well as state claims by the declaratory defendants. Accordingly, plaintiffs' action for declaratory judgment is raising a defense in anticipation of an impending, federal action, and federal 'arising under' jurisdiction is clearly present under Skelly Oil and Wycoff."

Accord: *Milton Roy Co. v. Bausch & Lomb, Inc.*, 418 F. Supp. 975, 978-79 (D. Del. 1976); *Dahlgren Manufacturing Co. v. Harris Corp., supra; Medtronic, Inc. v. American Optical Corp.*, 327 F. Supp. 1327, 1331 (D. Minn. 1971). The propriety of such a view seems to have been recognized by the Seventh Circuit in *Milprint, Inc. v. Curwood, Inc., supra,* 562 F. 2d at 421.

Finally, it should be noted that SPS has not taken issue with the allegations of the complaint to the effect that the parties are of diverse citizenship and that the amount in controversy exceeds $10,000 exclusive of costs and interest. Hence, jurisdiction over Count III exists regardless of whether it might otherwise be held to arise under the patent laws. *Milprint, Inc. v. Curwood, Inc., supra,* 562 F. 2d at 422 n. 5; *Arvin Industries, Inc. v. Berns Air King,* 510 F. 2d 1070 (7th Cir. 1975).

Accordingly, SPS's motion to dismiss Count III for lack of subject matter jurisdiction is denied.

Opinion

Next, SPS moves for summary judgment on Count III on the basis that the May 3, 1971, consent decree is *res judicata* as to the issues of the validity and infringement of the Villo patent. It is clear in this circuit and elsewhere that a consent decree containing an adjudication of the validity of a patent, but lacking an express or implied adjudication of infringement, will not be accorded *res judicata* effect in a later action between the parties. *Kraly v. National Distiliers & Chemical Corp.*, 502 F. 2d 1366 (7th Cir. 1974); *Business Forms Finishing Service, Inc. v. Carson*, 452 F. 2d 70 (7th Cir. 1971); and *see, e.g. Addressograph-Multigraph Corp. v. Cooper*, 156 F. 2d 483 (2nd Cir. 1946). However, "the question . . . whether a consent judgment adjudicating infringement as well as validity bars a party to the judgment from subsequently challenging the validity of the patent has not been decided by . . . [the Seventh Circuit]." *USM Corp. v. Standard Pressed Steel Co.*, 524 F. 2d 1097 (7th Cir. 1975). In opposing the motion, USM argues that such an application of *res judicata* is precluded by *Lear v. Adkins*, 395 U.S. 653, 89 S. Ct. 1902, 23 L. Ed. 2d 610 (1969). In *Lear*, a patent licensee sought to raise the invalidity of the underlying patent as a defense to the patentee's suit for royalties, there having been no prior litigation between the parties concerning the patent. At the time, the law afforded at least some support for the notion of licensee estoppel, which precluded a licensee from attacking the validity of the underlying patent so long as his license remained intact. The court framed the issue as one of determining priority between the principles of contract law upon which licensee estoppel was based and the public policy favoring free competition in the use of ideas not meriting patent protection. 395 U.S. at 670. In this vein the court rejected the doctrine of licensee estoppel, concluding that:

> "Surely the equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality part of the public domain. Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery. If they are muzzled, the public may continually be required to pay tribute to would-be monopolists without need or justification. We think it plain that the technical requirements of contract doctrine must give way before the demands of the public interest in the typical situation involving the negotiation of a license after a patent has issued." 395 U.S. at 620-21.

It can well be said, then, that the present situation differs significantly from that in *Lear*. Here, unlike in *Lear*, the license agreement entered into by the parties has been merged, in its relevant provisions, into a consent decree. Such a decree is to be viewed as a judicial act, rather than as a contract, *United States v. Swift & Co.*, 286 U.S. 106, 115, 52 S. Ct. 460, 462, 76 L. Ed. 999 (1932), and is generally accorded full *res judicata* effect. *United States v. Southern Ute Indians*, 402 U.S. 159, 91 S. Ct. 1336, 28 L. Ed. 2d 695 (1971); *Wallace Clark & Co., Inc. v. Acheson Industries, Inc.*, 532 F. 2d 846 (2nd Cir. 1976); 1B Moore's Federal Practice §0.409[5]. The doctrine of *res judicata* is not an entirely inflexible one, however, and rare exceptions are made for reasons of public policy. 1B Moore's Federal Practice §0.405[11]. Such exceptions have been recognized in the context of patent litigation. *See Schlegal Manufacturing Co. v. USM*

Corp., 525 F. 2d 775, 778-79 (6th Cir. 1975). The issue then becomes whether in the present context the public's interest in stripping an invalid patent of its government-protected monopoly so counterbalances the policy considerations underlying the doctrine of *res judicata* -- considerations surely more fundamental than those founding the once doctrine of licensee estoppel -- as to warrant the creation of another such exception.

Bearing this in mind, *res judicata* effect should be given to the May 3, 1971, consent degree. While it is indeed a difficult assessment to make, this court is inclined to agree with the view that:

> "The danger of some extension of unwarranted monopolies is outweighed, . . . by the threats to enforcement of valid patents and proliferation of expensive and time consuming litigation necessarily following upon denial of the usual res judicata effect to such decrees." *Wallace Clark & Co., Inc. v. Acheson Industries, Inc.*, 532 F. 2d 846, 849 (2nd Cir. 1976); and *see Schlegel Manufacturing Co. v. USM Corp.*, 525 F. 2d 775 (6th Cir. 1975).

Moreover, unlike in *Lear* it does not appear in this case that the juxtaposed policies are necessarily in direct conflict. More specifically, a persuasive argument can be made that the public interest in close scrutiny of patents would in itself be better served by affording *res judicata* effect to such a consent decree. It seems somewhat anomolous to strive to free useful ideas from the constraints of invalid patents by providing interested parties with a convenient means of postponing adjudication which might

achieve such a result. As the court said in *Schlegel, supra,* 525 F. 2d at 781:

> "The public interest requires that an invalid patent be stripped of its monopoly, and at as early a date as possible. When a consent decree is to be given res judicata effect, litigants are encouraged to litigate the issue of validity rather than foreclosing themselves by a consent decree. If they were given a second chance to litigate the issue of validity, alleged infringers might well accept a license under a consent decree and forego an attack on validity until favored by a stronger financial position, or until threatened by other manufacturers who were not paying royalties. By giving res judicata effect to consent decrees this court protects the public interest in that an alleged infringer is deprived of a judicial device which could be used to postpone and delay a final adjudication of validity."

And *see Res Judicata Effects of Consent Judgments in Patent Infringement Litigation,* 36 Federal Bar Journal 171 (1977).

Finally, this court recognizes and dismisses the possibility of adopting a case-by-case approach to the *res judicata* issue. Such an approach might involve consideration of such factors as the extent to which discovery on the issues of validity and/or infringement was taken prior to entry of the consent decree, the degree of judicial involvement in and scrutiny of negotiations resulting in the parties' agreement, the time remaining in the life of the patent, and the size of any royalty payments required. In the related context of determining the proper *res judicata* effect

of a patent litigation settlement agreement not incorporated in a court decree the Second Circuit has expressly rejected such an approach, finding that it would "leave the parties at the mercy of what inevitably would be an imprecise and uncertain test." *Warner-Jenkinson Co. v. Allied Chemical Corp.*, 567 F. 2d 184, 188 (2nd Cir. 1977). Cf. *Aro Corp. v. Allied Witan Co.*, 531 F. 2d 1368 (6th Cir. 1976). This observation is equally true and decisive here, the need for some clear and certain rule being of paramount importance in both contexts.

Accordingly, SPS's motion for summary judgment on Count III is granted.

SPS's third motion is one for summary judgment on Count II. Count II alleges that certain provisions included in the April, 1971, SPS-USM license agreement at SPS's insistance constitute misuse of the Villo patent, rendering the patent and license agreement unenforceable. The license agreement provides that, in the general case, USM is to pay SPS 25% of any royalties collected from sublicensees. However, with respect to each of four named corporations which SPS had already licensed under the Villo patent, USM, if it granted a sublicense, was to pay SPS 75% of any royalties, unless the sublicensee maintained its SPS license. If one of the named SPS licensees became a USM sublicensee, it would be permitted to deduct most (75%) but not all of its royalty payments to USM from the amounts due to SPS.

A wide variety of practices may constitute patent misuse. Many of these involve particular types of license restrictions. In each case, however, the essence of patent misuse consists of an attempt by the patent holder to gain for himself rights not inherent in the patent itself, or to extend his monopoly beyond that legally

granted to him. 7 Deller's Walker on Patents §518 (1972). Here, USM has presented evidentiary materials which, although not entirely uncontradicted, indicate that the sole purpose of the differential royalty rates was to erect an economic barrier to its sublicensing of the four SPS licensees, thereby preserving for SPS a market in patch-type fasteners free from the competition of USM's less expensive production technique. Even if this is accepted as wholly correct; this court would not characterize the arrangement as a patent misuse. The very essence of the patent grant is the exclusive right to manufacture, use, and sell the patented article. Thus, as assignee of a patent, SPS was legitimately entitled to have for itself a competition-free monopoly over the entire market for fasteners falling within the scope of its claims. It would seem necessarily to follow, then, that absent some tendency of the license restrictions to restrict competition in areas outside the patent, SPS could simply relinquish a portion of its monopoly market, retaining the rest for itself. This in effect is no different from the use of territorial or field of use limitations in a patent license. Such restrictions are generally upheld, 8 Deller's Walker on Patents §649, §651 (1973). Moreover, given this court's finding of the *res judicata* effect of the prior consent decree as to the issues of the validity and infringement of the Villo patent, it cannot be argued that SPS misused the Villo patent by seeking to enforce it with respect to goods falling outside of its claims. However, Count IV of the amended and supplemental complaint, which alleges patent misuse in the form of attempting to enforce a patent obtained by fraud, remains.

Accordingly, SPS's motion for summary judgment on Count II is granted.

Opinion

Finally, SPS has moved for separate trials of Counts III and IV, with Count IV to be tried first. In view of the rulings contained herein, this motion is mooted. Counts V and VI, alleging antitrust violations, have previously been severed for trial. Counts II and III have been disposed of. That portion of Count I which can be said to remain merely asks that certain portions of the 1971 consent decree be set aside on the basis that the Villo patent was obtained by fraud. Hence the allegations of Count IV now stand alone for trial, to be followed, if necessary, by trial of Counts V and VI.

In summary, then:

1. SPS's motion to dismiss Count III is denied.

2. SPS's motion for summary judgment on Count III is granted.

3. SPS's motion for summary judgment on Count II is granted.

4. SPS's motion for separate trial is mooted.

Further, this court finds, pursuant to Rule 54(b) F.R. Civ. Pro., that there is no just reason for delay in the entry of final judgment on its findings herein granting SPS's two motions for summary judgment, and directs the entry of judgment on Counts II and III accordingly.

s/ Nicholas J. Bua
Nicholas J. Bua
United States District Judge

DATED: June 12, 1978

EXCERPTS FROM THE DEPOSITION OF WILLIAM F.G. DAWSON TAKEN DECEMBER 17, 1975

Q Go back to the time frame of prior to April 1971. Do you recall anyone at that point in time raising the question as to the effect of the judgment order on consent and USM's right to question the validity of the Villo patent thereafter?

A No.

Q Were you the person at USM who made the policy decision to go forward with the present litigation?

A Yes, sir.

Q Can you tell me whether or not there was an economic reason for making the decision to go forward with the present litigation?

A Yes, sir.

Q What was the economic condition?

A The growth of USM's patch business had gone very well.

Q What do you mean by "very well," sir?

A Our business in Nylok patch had grown, the income from Nylok patch therefore had grown, and the payments being made to SPS under the agreement and those projected to be made to SPS under the remainder of the agreement had become substantial.

Excerpts from Deposition

Q Prior to the commencement of the present litigation, did you consider the possibility of asking SPS to terminate the agreement of April 12, 1971?

A Yes, sir.

Q Did you ask SPS to terminate the agreement?

A Not to my recollection.

Q Why not?

A It didn't seem like a very sound thing to ask.

Q Why?

A Because I'm not in the habit of cancelling agreements without having a sound business position to fall back to.

Q I do not understand that, sir.

A If I do not see a clear advantage, or, if you like, a clear riskless advantage, to cancelling an agreement, I would not cancel it. We go into agreements of any sort, this one included, with the object of living with that agreement unless conditions change. We do not go into agreements with the idea that we will only live with them for a short period of time and then cancel them. Therefore, we will only take action on agreements if conditions have changed.

Conditions had by 1974 changed; therefore, it seemed worthwhile to reopen the subject of this agreement. Cancelling

of the agreement is available to us, and, as a matter of fact, at one point, due to some unhappiness with lack of action on the part of SPS in defending what we felt we were paying for, we withheld payment. We withheld payment to the point where the agreement would have been cancelled. We then paid, so we showed the desire to maintain this agreement unless we could come to an arrangement more satisfactory to USM under new conditions. As a result, I believe there was some discussion between USM and SPS as per changing the agreement. As I recall, SPS saw no reason to change it.

We would leave ourselves badly unprotected if we had cancelled the agreement, so, under those circumstances, I did not think it would be a wise course to merely cancel the agreement. I don't think we would have had to ask permission to cancel the agreement. As I recall, under the clauses of the agreement, we could take that action unilaterally.

* * *

Q What do you mean by the statement "badly unprotected"?

* * *

A We would, in my view, have been — that we would have been forced to defend ourselves in expensive litigation brought on by SPS if we cancelled the agreement.

And you will note that we — even with this litigation, we have not cancelled the agreement.

Excerpts from Deposition

Q I believe you stated, sir, that the conditions changed between April 1971 and when the present litigation was brought, and it is my recollection that you said that business in the Nylok patch had grown considerably; is that correct, sir?

A Yes, sir.

Q Whose business in the Nylok patch?

A The stream of royalty payments being made to our Nylok licensing division had grown.